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Dear John

Ofwat: A Vision for the Sector: Workforce Resilience in the new vision for water

Thank you for the meeting with me on 1 August 2019 and for the valued invitation to provide further input on securing workforce resilience within the new vision that Ofwat is developing for the water industry in England and Wales.

This letter builds on our discussion plus my letter to Ronan Palmer dated 19 November 2018 (copy included) and the follow up meeting with Jonathan Read on 1 April 2019.

I committed to summarise the key points only and so should any further clarification or extrapolation be helpful, do please let me know.

Principles for ensuring workforce resilience for the water sector in England & Wales

1. Foundation principles

Ofwat set out explicitly in the *Resilience in the Round* approach, and across the *PR19 Final Methodology* just how vital workforce resilience is to the sustainability of the water industry in the long term. Of the three pillars of resilience set out, workforce was seen by Ofwat as critical to two - *operational* and *corporate* resilience. PR19 set out in some detail the short to long term planning required. So far, none of these statements or guiding principles have been carried across to the new Ofwat vision. **I recommend including these previous statements and principles as part of the foundation stones for developing the new Ofwat vision and ensuring continuity in approach for the sector**

2. Labour market state

a) Throughout the period that Ofwat has been developing the PR19 price review and this new vision, the UK labour market has continued to tighten. The labour market remains at

its most constrained since the Office of National Statistics records began in 1975, and HM Treasury continue to describe the UK as “*at full employment*” economically.

This evidenced market constraint and its continued tightening should be referenced within the new Ofwat vision and inform its direction

- b) Competition for talent between the four UK nations; between the UK and its international counterparts and between UK and international business sectors, has also continued to increase. These extraneous factors could not realistically be managed by any one water company in isolation in its business planning, and so **it is vital that the new Ofwat vision provides the thought leadership and overall stewardship to take account of the potential impact on the water sector.** This would also help Ofwat to directly show how it is meeting its statutory duties to resilience and sustainable development whilst enhancing social value

The situation does require wider thinking from Ofwat, as an individual water company could excel in delivering a comprehensive workforce strategy, only to find that its human capital investment is aggressively head hunted away by other employers or sectors who don't make equivalent commitments. The water company could find itself priced out of affording the very labour market required to be efficient, or its costs greatly increased, through no fault of its own

- c) Ofwat has already begun to recognise and mitigate against these extraneous labour market factors within its PR19 price review approach. In the PR19 Draft Determination approach, Ofwat indicates it will make real price effect adjustments for labour costs, based on Office of Budget Responsibility forecasts of labour productivity and real wage growth. **I recommend that this overall approach and recognition is now carried across to the new Ofwat vision for water**

3. Better regulation and coherent policy approaches

- a) In the proposition papers for the new vision, Ofwat indicated that it will change its approach from that of only direct regulation of companies to consider a wider role, taking in to account other stakeholders needs and wider societal and environmental issues

This enhanced perspective is welcomed and Ofwat intervention will be important in maintaining the long-term resilience of the sector. With the subject of maintaining the necessary human capital, **we see no evidence that Ofwat can yet rely on other existing government policy frameworks to protect the sector's efficiency, productivity, workforce resilience and sustainability**

- b) Whilst UK industrial strategy, employment and labour market policy typically sits within central government, the vital skills and upskilling side is increasingly a devolved matter and continues to fragment down to local authority level. There is no coherent approach between the two disciplines, and in the key policy areas the responsible authorities often

act in opposition or direct competition to each other. Energy & Utility Skills is in ongoing dialogue with the No.10 policy unit, BEIS Industrial Strategy team and the skills departments within the four nations to try to secure a coherent UK approach and Ofwat assistance would be highly valuable

- c) Poor recognition of the critical water workforce within UK government policy is long standing and wide-ranging issue

At the current time, the water industry has no explicit support for its labour market sustainability or workforce resilience needs from the main UK *Industrial Strategy*, which is led by BEIS. HM Treasury is invisible in providing support for the regulated water sector in its UK infrastructure resilience planning or within its overall governance of the UK Apprenticeship Levy, despite being the guiding mind for UK infrastructure policy

The National Infrastructure Commission has demonstrated similarly low levels of support and recognition for protecting and developing the water sectors human capital, and recently indicated that it is unlikely to consider workforce resilience or the supply chain as part of its impending *Infrastructure Resilience Study* despite calls from bodies across the UK

The Infrastructure & Projects Authority currently owns the *National Infrastructure Plan for Skills* to ensure the £0.6 trillion *National Infrastructure Plan* is delivered. This document is now years out of date and despite efforts from my organisation and Directors of Ofwat, does little to recognise or offer any support for sustaining the water sector's human capital

- d) Energy & Utility Skills is now leading the dialogue with the Home Office *migration, immigration and skills policy* teams this autumn, after it became clear that the long-term water plans of Defra, Ofwat, the Environment Agency, the Drinking Water Inspectorate and their UK counterparts were all unknown to them. This lack of recognition within the Home Office was also apparent for the other utility sectors
- e) Even Defra as the main sponsoring department for water in England, has yet to build workforce resilience in to its strategic policy statements and strategies in order to ensure that the whole sector it governs prioritises labour market sustainability. It has also done nothing yet apparent to ensure that water strategy workforce needs are represented in the appropriate policies of other government departments

Ofwat should set out in its vision, how it will work in the future to not only regulate the water companies directly but also engage with relevant UK and devolved governments, regulators and key groups, to ensure that the long-term operating environment for the water industry is optimal. This should include workforce resilience and protecting human capital

- f) Energy & Utility Skills will support Ofwat as needed, and I offered to provide a summary of the main current policy 'pinch points' if this would assist

4. Long-term operational resilience

Energy & Utility Skills supports the Ofwat focus on ensuring and securing long-term operational resilience

In its PR19 Final Methodology, Ofwat set out how companies should address longer-term planning, by thinking not only just for the five-year price review periods, but also planning for a further ten years beyond. We already see this approach widely adopted in water resource management and wider asset management planning and strongly recommend it continues as a requirement including for ensuring workforce resilience

5. Supply chain

- a) To ensure that each company had a workforce strategy capable of delivering its core aims, Ofwat advised in its previous resilience and price review documents that they should think not only for their directly employed labour force but also for their vital supply chain. **This approach is vital to sector sustainability given their contribution within the current UK operating model and we encourage Ofwat to continue to embed this across its new vision**
- b) In our meeting, I stressed to you the vital role that the contracting community and major supply chain partners currently play right across the UK water business model and the importance of giving them a stable and predictable business environment. This is explained in more detail in my earlier letter to Ronan (attached) where I also proposed increased communication between Ofwat and the contractors to help maintain their confidence in the water regulatory model. As part of this, Rachel Fletcher and David Black were invited to meet the leaders of these companies, who typically have UK utilities as one part of a wider portfolio

The major new water industry commitments that have been announced, such as those set out in the Water UK *Public Interest Commitment*, remain unlikely to be able to be delivered by the current directly employed workforce alone, even when the moves towards more insourcing that has been seen in some company business plans is considered

Ofwat will therefore need to seek assurance from companies that meeting workforce resilience does in fact apply to their whole labour force, including their supply chain, as has been clearly set of in the *PR19 Final Methodology* and *Resilience in the Round*

These vital strategic water commitments for society are likely to continue to rely heavily on the non-direct labour force, and I recommend that Ofwat take this in to account in its new vision

- c) The major water commitments are currently scheduled to commence just as the critical delivery partners are also required to support other government infrastructure ambitions around electric vehicle installation, broadband enhancement, smart metering installations, waste to energy policy and rail and road infrastructure. In addition, these supply chain companies will be courted by countries such as Eire, France, Holland etc. for their equivalent programmes. **The water sector, including Ofwat, needs to make sure these vital partners see the water business environment as a priority if it is to continue to access the labour force it needs, to maintain productivity and prevent undesired cost increases**
- d) I mentioned the conclusions on workforce resilience from the previous Infrastructure UK study *Smoothing Investment Cycles in the Water Sector*, where they looked at the impacts of cyclical price reviews on employment. At that time, the Treasury team concluded that between 20,000 to 40,000 workers would be lost and then re-hired due to the cyclical effects of each price review. It would cost around £600m each year and take away vital corporate memory, competence and compliance knowledge. **As you are aware, we are already seeing the first public announcements of such job losses from water companies and their supply chain associated for the PR19 review**

6. Union engagement

I recommended Ofwat connecting the main trade unions with the developing vision wherever possible, to bring in their wide perspective and knowledge of UK labour market and government employment matters and multiple utility sectors. Energy & Utility Skills work closely with the TUC, GMB, Prospect, Unison and Unite on ensuring utility-wide workforce resilience and we would be pleased to assist if and where we can help

The TUC, for example, are already key partners of the Westminster government in developing and launching the major National Retraining Scheme and are working with universities and investors to help ensure that workforce adaption to zero carbon policies is sustainable. They maintain a passionate, informed and focused approach to maintaining a safe, skilled and sustainable workforce whilst promoting fulfilling careers in the utility sector

7. Investor Engagement

Ofwat invests significantly in ensuring that the investment community is aware of the evolving regulatory model and is informed as to how the major risks are being mitigated. With human capital, investors have become increasingly concerned as to the lack of available information and have increased their focus through their *Environmental, Social and Governance (ESG)* functions. They are also working together through a charity called *Share Action* and have launched the *Workforce Disclosure Initiative (WDI)*. One hundred and twenty six institutional investors with £9 trillion under management, are now seeking assurances as to how companies are protecting their human capital and strategically turning in to human equity.

I recommend that the new Ofwat vision for water connects with the ESG teams within the main water investors, and links with the WDI initiative. I would be pleased to make any necessary links.

*Aberdeen Standard Investments recently advised in *The Water Report* “Our attention on human capital management and labour issues has significantly increased over the recent years. We consider these issues important, not just from an ESG investment perspective as a socially responsible investor, but also in respect of their link to sustainable business performance of companies, which ultimately will have an impact on shareholder value. This attention is only going to increase as more meaningful workforce data becomes available and more companies start to take human capital management seriously as a key driver of value creation.”*

8. Regulatory and policy excellence

Whilst the Ofwat approach has so far focused primarily on ensuring workforce resilience for the regulated water companies, it is important for the wider vision for the sector to also encourage the highest possible quality of workforce within the economic, quality and environmental regulators and policy makers. **The new Ofwat vision for water should take this in to account**

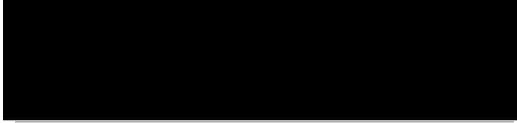
The UK water sector continues to be held in the highest esteem across the world for its collective achievements and quality standards, and if the new water vision is to ultimately bring excellence to society it will be incumbent on us all to ensure that the best possible talent is working in each vital part of the system. To simply compete for the talent that exists is expensive, inefficient and unsustainable and it will require a coordinated effort

I look forward to hearing more regarding the developing vision John and thank you again for the ongoing support and engagement with this area.

I will of course continue to keep the Ofwat team closely briefed on the work that is underway right across the water, gas, power and waste management industries, through the *Energy & Utilities Skills Partnership*, to ensure we all have the human capital we need for the future. This initiative complements the significant additional work that is also going on at a company level, extending from new levels of primary school engagement right through to optimised activity at the end of working life.

The Ofwat team continues to play a positive and proactive role across this work, engaging directly with the initiatives and encouraging new talent to join the sector. The support from your entire team is greatly appreciated.

Yours sincerely



Nick Ellins
Chief Executive